

KSA Cabinet approves Double Tax Treaty with the UAE

March 2019

In brief

On 1 March 2019, the Kingdom of Saudi Arabia (“KSA”) published the Double Tax Treaty (“DTT”) with the United Arab Emirates (“UAE”) in its Official Gazette (Ummul Quraa). The DTT between the UAE and KSA (the “contracting states”) has not yet been published in the UAE Official Gazette.

A summary of the key provisions of the DTT is listed below:

- An exemption from withholding tax (“WHT”) on interest and service fees
- A reduced WHT rate of 10% on royalty payments
- A maximum 5% WHT on dividends (same as the domestic dividend WHT rate in KSA)
- No relief from non-resident taxation on the transfer of shares or immovable property
- Foreign national residents of the UAE or KSA may also benefit from the DTT
- Sovereign Wealth Funds and certain entities that are exempt from tax expressly qualify for DTT benefits.

The DTT is expected to enter into force on the first day of the second month following the month in which the UAE publishes the DTT in its Official Gazette. For example, if the UAE publishes the DTT in its Gazette in March 2019, the DTT should come into force from 1 May 2019.

In detail

Persons covered (Article 1)

KSA and UAE resident individuals and companies have access to the DTT.

For individuals, residency for DTT purposes is not limited to UAE and KSA nationals only. Foreign national individuals who are resident in the UAE or KSA may also benefit from the DTT.

Resident (Article 4)

Residents covered by the DTT include: (i) any person liable to tax by reason of domicile, residence, place of incorporation or place of management (ii) corporate entities (iii) Sovereign Wealth Funds and similar government entities*, and (iv) other persons that are exempted from tax (because of religious, educational,

charitable, scientific or any other similar reasons).

The DTT contains a tie-breaker rule for corporate tax residence which is based on the place of effective management of the company. The current rule for determining DTT residence under the 2017 Organisation for Economic Cooperation and Development (“OECD”) Model Tax Convention is the mutual agreement procedure.

* The DTT is not clear on which ‘similar government entities’ are meant to be covered.

Permanent establishment (“PE”) (Article 5)

Under the DTT, a “service PE” will exist only if services are carried out by an enterprise of a contracting state through employees or

other personnel engaged by that enterprise within the borders of the other contracting state for a period of more than 183 days in any 12 month period. The domestic PE definition in KSA does not have a de minimis threshold.

A PE would also arise if a building site, construction, assembly or installation project in the other contracting state lasts for a period of more than six months.

Business profits (Article 7)

Under KSA domestic law, service fees attract WHT at a rate ranging from 5% to 20% depending on the type of service and whether the recipient is related to the service provider.

The DTT provides that profits of a company are not subject to tax in the other contracting state unless the company carries on its business in that other contracting state through a PE. In addition, the DTT provides that items of income that are not specifically dealt with in the DTT are taxable only in the contracting state where the recipient is resident.

As such, income from services that are not delivered through a PE in the other contracting state should be exempt from WHT and other forms of taxation in that state.

Where activities do give rise to a PE, the DTT provides guidance on the mechanisms to attribute profits to such PE.

International shipping and air transport (Article 8)

The DTT provides that profits derived from the operation of ships and aircraft in international traffic are only taxable in the state where the effective management of the respective company is located.

Dividends (Article 10)

The DTT caps the WHT on dividends to 5%. As such, the DTT currently offers no relief from WHT on dividend payments (5%) from KSA to the UAE.

No WHT is levied on the payment of dividends in the UAE.

Income from debt claims / interest (Article 11)

The DTT provides that interest is taxable only in the contracting state in which the recipient is

resident. As such, no WHT should apply on interest payments between UAE and KSA residents (domestic WHT on interest is 5% in KSA, and 0% in the UAE).

The definition of interest under the DTT includes interest from government securities, bonds and debentures, premiums, and other bonds or debentures.

Penalty charges that apply to the late payment of interest do not benefit from DTT relief.

Royalties (Article 12)

The DTT caps WHT on royalty payments (which includes payments for the use of or the right to use industrial, commercial or scientific equipment) at 10%. This is a reduction from the domestic KSA royalty WHT rate of 15%.

Capital gains (Article 13)

The DTT does not exempt gains arising on the transfer of (i) shares, and (ii) immovable property from taxation in the other contracting state.

The transfer of shares in listed companies is exempt from tax under the DTT; in any event, such gains would not attract taxation in KSA under domestic law.

Elimination of double taxation (Article 24)

The DTT provides for the elimination of double taxation by way of a credit against tax payable in the UAE and KSA (except against Zakat payable in KSA).

Mutual Agreement Procedure (Article 25)

Article 25 of the DTT allows taxpayers to seek assistance

from their local competent authority in resolving disputes relating to the interpretation of the DTT, within a period of three years (from the date of the “notification” of the dispute to the relevant tax authority).

Sovereign exemption (Article 27)

The DTT provides that investments by UAE or KSA government bodies and public financial institutions are exempt from taxation, and that income from “government investments” (with the exception of investments in real estate) is also exempt from tax.

Entry into force (Article 30)

The DTT should enter into force on the first day of the second month following the month in which the UAE publishes the DTT in its Official Gazette.

OECD Multilateral Convention

The UAE and KSA have both signed the OECD Multilateral Convention (“MLI”) to implement the DTT-related Base Erosion and Profit Shifting (“BEPS”) measures and minimum standards into (selected, i.e. “covered”) DTTs.

The UAE has chosen to include a so-called Principal Purpose Test (“PPT”) in their covered DTTs. The PPT is a general anti-abuse rule which denies DTT benefits where one of the main purposes of a transaction or arrangement is to access the DTTs, unless it can be shown that granting DTT benefits would be appropriate in the circumstances.

KSA did not make any specific election in respect of the minimum standard for DTT eligibility.

Because the UAE did not include the UAE-KSA DTT as a covered DTT for purposes of the MLI, the new PPT standard would currently not apply to the UAE-KSA DTT.

That said, Article 29 of the DTT includes a PPT

provision preventing DTT relief where one of the main aims of a transaction is to obtain DTT relief.

As such, it is important that UAE and KSA entities seeking to claim relief under the DTT have appropriate operational substance and can support a principal commercial purpose. This is in addition to meeting the minimum substance and

procedural requirements set by the UAE and KSA.

The takeaway

The DTT between KSA and the UAE is the first DTT between two GCC member states, and is expected to facilitate further cross-border trade and investment between the two countries. The DTT is largely in line with the 2014 OECD Model tax Convention.

The DTT provides for some important changes to the taxation of payments (e.g. interest, royalties service fees) between the countries and includes a definition of the types and levels of activities that would create a taxable presence in the other country. This may reduce taxation and compliance obligations and provide taxpayers with greater certainty.

Both KSA and UAE resident individuals and companies have access to the DTT. For individuals, residency for DTT purposes is not limited to only UAE and KSA nationals.

The DTT is expected to come into force shortly after the UAE publishes the DTT in its Official Gazette.

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